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IN THE

Supreme Court of the United States

OCTOBER TERM 1962

No. 553

ASSOCIATED TELEPHONE AND TELEGRAPH COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN SUPPORT OF PETITION FILED ON BEHALF OF COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK, INC., AS *AMICUS CURIAE*

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The Commerce and Industry Association of New York, Inc. is a membership corporation organized in 1897 under the laws of the State of New York, "to foster the trade and welfare of New York." It has a membership of some 3,500, drawn from all sections of the business world. It is the largest organization of its kind in the United States.

The Association and its members have a particular interest in foreign trade and foreign investments which are so important to the Port of New York. A large pro-

portion of its membership is engaged in foreign trade or has foreign investments of one kind or another.

Its membership includes many of the largest corporations in the United States, who have executive offices in New York City. Many of these corporations have foreign subsidiaries and hence have a very direct interest in the proper determination of the credit for foreign income taxes under the Internal Revenue Code, particularly where distributions from a foreign subsidiary are involved.

The Association and its members believe that the petition should be granted because the Court of Appeals for the Second Circuit, in conflict with principles established by this Court, has erroneously construed Section 902(a)* of the Internal Revenue Code of 1954 in such a way as to subject the earnings of foreign subsidiaries when distributed on liquidation to double international taxation, contrary to the provisions of the statute and contrary to the general purpose of Sections 901 to 904, inclusive, to prevent double taxation by the United States and foreign countries of such income. See *American Chicle Co.* v. *United States,* 316 U. S. 450 (1942).

Furthermore, the Court by its construction of the statutes has imposed a limitation on the credit for foreign income taxes, which is not provided for in the statute and which is inconsistent in principle with the sole statutory limitation on such credit provided for in Section 904(a).

The question involved in this case is an important question of Federal law which has not been but should be settled by this Court. The question seriously affects the decisions of taxpayers generally, and of members of this

* All references to Sections herein are to the Internal Revenue Code of 1954.

Association with respect to engaging in, or increasing investments in, business in foreign countries. The decision below is probably in conflict with principles established by decisions of this Court, as the construction made of the statute is not based on any terminology in the statute as enacted and reaches a result which is not consistent with the purposes of Congress as expressed in the statute.

The Association, accordingly, submits this brief *amicus curiae* in support of the petition for a writ of certiorari filed by Associated Telephone and Telegraph Company and urges that the writ be granted for the reasons set forth below.

The references to the decisions below, the statements re jurisdiction, the question presented, and the statutes and treaty involved, are adequately stated in the petition for certiorari filed by the petitioner.

The consents of the parties to this brief *amicus curiae* have been filed with the Clerk of the Court.

Statement

An American corporation in 1954 received from its wholly owned Canadian subsidiary a distribution in complete liquidation of $9,574,386.10. This distribution included $6,322,088.64 of earnings and profits accumulated by the Canadian subsidiary, on which it had paid Canadian income taxes of $2,387,564.86.

The distribution was taxed by Canada as a dividend to the extent of the earnings and profits distributed, at the rate of 5%, which tax was withheld at the source. The distribution gave rise to a large capital gain to the parent company subject to a 25% U. S. income tax.

Credit for foreign income tax has been allowed under Section 901(a) for the 5% Canadian tax on the distribution of the earnings and profits, but the Court below, reversing the District Court, held that no credit was allowable to the American parent corporation under the "deemed paid" provisions of Section 902(a) for the Canadian taxes which had been paid on the earnings and profits distributed, on the ground that the word "dividends" as used in Section 902(a) did not include a distribution of earnings and profits as part of a liquidating dividend.

Argument

The Court below concluded that the meaning of the word "dividends" as used in Section 902(a) was ambiguous. It ignored the statutory definition of the term "dividend" in Section 316(a) for all purposes of the income tax subtitle as applicable to that word as used in Section 902(a). It held that on consideration of the policies behind the foreign tax credit allowance generally and the policies behind Section 902(a) in particular, the term "dividends" as used in Section 902(a) should be construed to exclude a distribution made by a foreign subsidiary of its earnings and profits if such distribution was made by a liquidating dividend rather than an ordinary dividend. The result was that no deemed paid credit whatsoever would be allowed and there would in this case be no relief whatsoever from the double taxation of this income, notwithstanding the recognized general purpose of the statute of avoiding double taxation.

We will not duplicate here the arguments made in the petition as to the respects in which the decision below conflicts with the applicable decisions of this Court

and the meaning of the statutory language in the light of the legislative history and the treaty with Canada. We fully concur in such arguments.

We submit, however, that the solution of the problem judicially evolved below on grounds of policy, does not in fact conform to the general policies underlying the foreign income tax credit provisions and Section 902(a). On the contrary, the decision below is inconsistent in principle with the sole limitation on the foreign income tax credit which Congress provided in Section 904(a) and is in conflict with the general purpose of the foreign income tax credit provisions to prevent international double taxation of the same income. The Court's decision does not result in a proper and equitable solution of the problem of possible excessive credits, differs from and is inconsistent with the statutory solution of that problem prescribed in Section 904(a), and results in an unwarranted and inconsistent distinction between the credit for foreign taxes paid directly by the U. S. taxpayer and the credit for those deemed to be paid by him under Section 902(a). This brief is devoted primarily to these aspects of the matter.

I. The complete denial of the foreign tax credit under the decision below is inconsistent in principle with the sole statutory limitation placed on such credit by Congress in Section 904(a).

The Court below apparently was principally influenced in giving a restricted meaning to the term "dividends" as used in Section 902(a), not by any terminology or language appearing in the statute, but by the belief that otherwise the credit for the Canadian tax paid by a subsidiary on its accumulated earnings might exceed the

U. S. tax on the capital gain resulting from the distribution of such earnings to its parent in liquidation. The Court thought that Congress never "intended" such a result and that the construction evolved by it was necessary to prevent tax avoidance.

The fundamental error in this approach is the failure of the Court to recognize that Congress did intend to allow a credit for foreign taxes where necessary to avoid double taxation, did consider what limitation should be placed on the foreign tax credit and specifically provided the single limitation set forth in Section 904(a). We submit that the complete denial of the credit evolved by the Court below is inconsistent in principle with the limitation provisions of Section 904(a) and contrary to the general purpose of Congress as to what credit should be allowed and how such credit should be limited.

For the taxable year 1954, here involved, Section 904(a) provided that the total credit for foreign income taxes paid or deemed to be paid to any foreign country shall not exceed the result of the following formula:

$$\frac{\text{Taxable income from such foreign country}}{\text{Entire taxable income}} \times \text{U. S. tax.}$$

By this provision Congress made certain that if, say, 50% of the taxpayer's entire net income was from sources within this foreign country, not more than 50% of the U. S. tax could be offset by the foreign tax credit. Hence, if the average foreign income tax rate (determined by comparing the foreign tax paid or deemed to be paid with the net taxable income from the foreign country) was less than the average U. S. tax rate (determined by comparing the U. S. tax with the entire net taxable income) the credit would be allowed for the full foreign income tax paid or deemed to be paid.

The significant fact is that in Section 904(a) Congress provided for the determination of the foreign tax burden and the U. S. tax burden on an overall basis in each case. Congress did not regard it as tax avoidance to allow credit for the full foreign income tax paid or deemed to be paid so long as the average rate of foreign tax did not exceed the average rate of U. S. tax. Furthermore, in order to avoid undue double taxation Congress intended that where the average rate of foreign tax was higher, the credit should, nevertheless, be allowed up to the limit measured by the average rate of U. S. tax. Congress, of course, knew that various categories of income of U. S. individuals and corporations were taxable under U. S. law at different rates. Both individuals and corporations are taxed at progressive rates. Long term capital gains are subject to a maximum tax of 25%. Some classes of income are only partially taxable or fully exempt, etc. Congress must have known that under an infinite variety of foreign income tax laws various items or categories of income would be taxed at different rates. Congress, in its wisdom, provided that the proper, workable and simple way of determining the relative foreign and U. S. income tax burden was to determine each by a comparison of the total tax with the total relevant net income. The limitation in Section 904(a) prevents the U. S. taxpayer whose average rate of foreign income tax exceeds his average rate of U. S. income tax from relieving the U. S. income from the full U. S. tax burden attributable to it on this overall basis, but at the same time allows the credit up to this limit.

The Court below conceded that this was the proper result under Section 901(a) as to foreign taxes paid directly by a U. S. taxpayer. It notes that with respect

to the direct foreign tax credit "a taxpayer may under certain circumstances receive a credit for foreign 'ordinary income' taxes which it could apply against the American capital gains tax." This point was decided in 1942 in *I. B. Dexter*, 47 B.T.A. 285, involving capital gain fully taxable in the Philippines, but only 30% of which was then subject to U. S. tax. The same result was reached in *Helvering* v. *Campbell*, 139 F. 2d 865, 870 (4th Cir. 1944), where certain income excluded from taxable net income under U. S. law was fully taxed by the Philippines, and in *James A. Brace*, 11 T.C.M. 906 (1952), where income earned in Canada by a U. S. citizen was taxed by Canada but exempt from U. S. tax. *Brace* was allowed to include in his foreign taxes paid the Canadian tax on his earned income, which was exempt from U. S. tax, and thus to offset, subject to the limitation of Section 904(a), his U. S. tax on his other income. In the various revenue acts enacted since 1942, Congress has made no change in the statutes affecting this matter. The Commissioner finally agreed to follow the Courts, Rev. Rul. 54-15, 1954-1 C.B.-129. Hence, the alleged revenue considerations which so troubled the Court below exist today under Section 901(a), with Congressional acquiescence therein for almost 20 years.

Nevertheless, the Court below thought that such a result might be so shocking in some cases and open up such an opportunity for tax avoidance that it must give a restricted meaning to the word "dividends" as used in Section 902(a) in order to effectuate the general policy of that section, and thereby denied any tax credit whatsoever where the U. S. taxpayer received a distribution in liquidation.

Why a result which Congress has not seen fit to change for 20 years in applying Section 901(a) to foreign tax paid

directly must be avoided as a matter of policy under Section 902(a) by a harsh denial of any credit whatsoever is not explained.

The denial of any deemed paid tax credit whatsoever under Section 902(a) because the ordinary foreign income tax paid by the foreign company on its accumulated earnings may in some but not all cases exceed the U. S. tax of 25% on the capital gain is inconsistent in principle with the overall clear and specific limitation on the total credit provided by Congress in Section 904(a), and results in one rule applicable to the direct foreign tax credit and a different and inconsistent rule applicable to the deemed paid foreign tax credit.

Congress perhaps could have adopted a much more complicated plan to allow a credit for foreign income taxes paid, limited in amount to the U. S. tax on the same item of income. As a legislative body it could have considered and dealt with all the complicated ramifications of such a plan.

There is every indication in the 1954 Code as enacted that Congress did not consider or intend to adopt any such item by item allowance of or limitation on the foreign tax credit, and that it did intend to allow a credit for all foreign income taxes paid or deemed to be paid, subject only to the overall limitation on the total credit provided for in Section 904(a).

II. The decision below results in double international taxation on the same income without regard to the relation between U. S. and foreign tax rates, contrary to the general purpose of the foreign income tax credit provisions.

There can be no question but that the general purpose of Sections 901 to 904 was to prevent undue international

double taxation of the income of a U. S. taxpayer derived from sources in a foreign country by permitting a credit against the U. S. tax for the foreign taxes paid on income also taxable by the United States. The Court below states this principle and cites the authorities:

There can be no question but that the general purpose of Section 902(a) was to permit a qualified U. S. corporate stockholder, in the year when such foreign profits were distributed to it as "dividends," to treat as foreign income taxes paid by it for this purpose, the foreign income taxes theretofore paid by the foreign corporation on the accumulated profits distributed, so that what was essentially the same income would not bear the burden of both the foreign and U. S. income tax.

The Court below, by giving the word "dividends" as used in Section 902(a) a more restricted meaning than it has in the statutory definition of "dividend" in Section 316(a), holds that no credit whatsoever for foreign income taxes paid by the foreign corporation on these accumulated earnings is allowed by the statute if such accumulated earnings are distributed to the American stockholder as a liquidating dividend rather than as an ordinary dividend.

The result is to cause this income to remain fully subject to such income taxes as the United States and as Canada chose to impose thereon, with no relief whatsoever from this double taxation.

The Court justifies its construction on the ground that otherwise in some cases the credit for the foreign income tax on a particular item or type of income might exceed the U. S. tax on that particular item or type of income, thus giving an opportunity in some cases for what the Court regarded as tax avoidance.

The Court's construction of the statute is, of course, equally applicable whether the foreign tax rate is more or less than the U. S. tax rate on the particular item.

If the foreign tax rate is 20% and the U. S. tax rate is 25%, the decision below leaves the income fully subject to both taxes, with no credit whatsoever for the lower foreign income taxes.

If the foreign tax rate is 30% and the U. S. tax rate is 25%, the decision below does not merely limit the credit to 25%, the U. S. rate, which is the general plan of the statute, but denies the credit altogether, leaving the income fully subject to both taxes.

Thus, while recognizing that the primary purpose of the foreign tax credit provisions was to eliminate double taxation, the Court below, because of its concern that the foreign tax rate on the item of income in question was higher than the U. S. tax rate on the same item of income, decided the case on a basis resulting in serious double taxation.

The Court below in construing the word "dividends" as used in Section 902(a) has thus reached a result which, when considered in the light of the policy underlying Sections 901 to 904,

(a) is inconsistent with the general statutory purpose of avoiding international double taxation;

(b) denies any credit whatsoever for foreign income taxes deemed to be paid where the accumulated profits are distributed in liquidation, whether or not the foreign tax rate exceeds the U. S. tax rate on the same income;

(c) in such a case, does not merely limit the credit to the amount of U. S. tax on the same income, which is the general pattern of the statute, but denies the credit

altogether in a situation where double taxation obviously exists.

We submit that the decision below defeats rather than promotes the general policies underlying Sections 901 to 904 and since based on policy grounds, rather than statutory terminology, should be reversed.

The petitioner's position, in contrast, fully accords with the general policy of eliminating undue double taxation.

The problems of excessive credits and possible tax avoidance, which were of decisive weight with the lower Court, are adequately dealt with and provided for by Congress in Section 904(a). (See Point I, *supra*). Congress having set the limits on the total allowable credit, these problems, which were the main basis for the decision below, are of no significance in construing the statute from the standpoint of underlying policies and purposes, and hence do not warrant the decision below.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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